

The place to be

NZIER business confidence down in Q4

- **Business confidence fell further in the December quarter, as global risks mounted and momentum in domestic activity slowed.**
- **The Canterbury region far outperformed the rest of the country, hinting at a broader rebound in business activity as well as support from reconstruction.**
- **Price pressures have eased in recent months, and inflation is likely to remain comfortably within the Reserve Bank's target range over this year.**

Summary

Business confidence fell for a second quarter according to the December *Quarterly Survey of Business Opinion*, undoubtedly weighed down by the slow deterioration in Europe as well as signs of cooling in some segments of the local economy. However, the Canterbury region once again bucked the national trend, reflecting a rebound in activity from post-earthquake lows as well as the early stages of reconstruction.

The survey results are broadly consistent with 0.4% growth in December quarter GDP, less than our current forecast and the Reserve Bank's expectation. On top of this, inflation pressures have clearly moderated since the first half of 2011, strengthening the case for leaving interest rates unchanged until later this year, once the Christchurch rebuild is well under way.

Details

In seasonally adjusted terms, confidence about general business conditions saw a sharp drop in the December quarter, down from a net +10% to -3%. This measure is typically more volatile than firms' own-activity expectations, which saw a more modest fall from 18% to 13%. Own activity, both actual and expected, was right on the average of the last two years, a period that has seen weakly positive GDP growth.

The other near-term activity indicators were also relatively resilient. Both reported and expected hiring rose slightly (and the former was positive for only the second time since the start of the recession); investment intentions were steady for buildings, but fell a little for plant and machinery. Actual and expected profits were lower for the quarter, although they were still among the strongest readings of the last seven years.

Key results – forward looking

| | Q3 survey | Q4 survey |
|--|-----------|-----------|
| Business confidence sa, next 6 mths | 10 | -3 |
| Trading activity, sa, next 3 mths | 18 | 13 |
| Pricing intentions, next 3 mths | 22 | 17 |
| Cost expectations, next 3 mths | 28 | 21 |
| Profitability, next 3 mths | 10 | 0 |
| Employment intentions, next 3 mths | 4 | 7 |
| Building investment intentions, next 12 mths | -6 | -6 |
| Plant investment intentions, next 12 mths | 6 | 0 |

Key results – backward looking

| | Q3 survey | Q4 survey |
|---|-----------|-----------|
| Trading activity, sa, past 3 mths | 1 | -4 |
| Pricing, past 3 mths | 18 | 10 |
| Costs, past 3 mths | 30 | 30 |
| Profitability, past 3 mths | -14 | -17 |
| Employment, past 3 mths | -4 | 1 |
| Ease of finding skilled labour, past 3 mths | -20 | -19 |
| Ease of finding unskilled labour, past 3 mths | 8 | 8 |
| Capacity utilisation | 89.63% | 90.15% |

By sector, expectations softened in retailing and services, although much of the decline can be put down to anticipation of the Rugby World Cup in the previous quarter. Reported activity for these sectors in the last three months was little changed. In contrast, manufacturers and builders reported a sharp slowing in the last quarter – a net 11% reported a decline in activity, the worst since September 2009 – although the outlook for the next quarter improved from 12% to 18%.

A closer look indicates that it was the building industry that had a particularly tough quarter. The balances for new orders, domestic sales, selling prices and profitability all turned sharply negative in the December quarter. Architects reported a much weaker outlook for residential work over the next year (down from +26% to zero), though they were more positive about commercial construction and public sector work.

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What's more, this decline can't obviously be blamed on delays to post-quake rebuilding in Christchurch. In fact, the handful of figures that NZIER provided for Canterbury suggests that activity in the region is rapidly bouncing back from its post-quake lows, both in the building industry and more widely. Firms' own activity rose from +7% to +18%, well ahead of the rest of the country at a net -7%. Hiring and investment intentions were also well ahead of other regions.

While the report didn't provide any direct measures of building activity in the region, there was tangential evidence that rebuilding is already creating localised cost pressures. A net 45% of builders in the region reported higher selling prices, compared to a net 25% reporting lower prices in the rest of the country. And the proportion of firms reporting capacity constraints as the main obstacle to growth rose from 7% to 18%, compared to 8% elsewhere.

It's also clear, however, that these localised inflation pressures have not spread to the wider economy – nor would we have expected them to at this stage. Nationwide capacity utilisation rose for a second straight quarter, but remains below the average of the previous decade. The difficulty of finding skilled workers was unchanged in December, after a period of persistent tightening since June 2009. Finally, expected costs and selling prices eased for a second quarter, leaving them well below mid-2011 levels. Soaring fuel prices, and a high headline inflation rate as a result of the October 2010 GST hike, may have worried businesses six months ago; these concerns are becoming more distant, and pricing expectations in this survey are now consistent with inflation remaining comfortably within the Reserve Bank's 1-3% target over the next few quarters.

Market implications

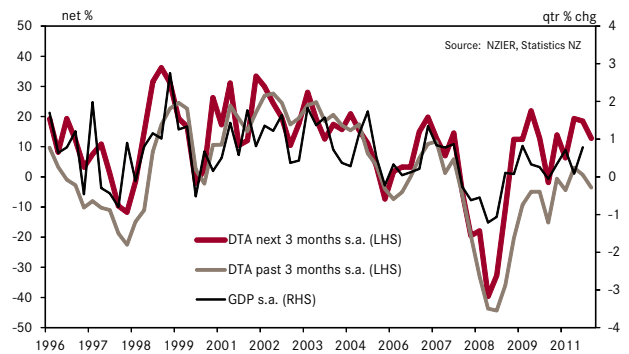
Firms' own activity in the last three months – the survey's single best indicator of quarterly GDP – is consistent with growth of around 0.4%, less than our current forecast of 0.9% and the RBNZ's pick of 0.6%. The main point of difference appears to be in housing construction – both we and the RBNZ expected a pickup in building activity in the December quarter, reflecting not just rebuilding in Christchurch but also a pickup in other regions to address the growing housing shortage. The QSBO suggests that the second aspect may have been slow to arise – if that's correct, then the flipside is that house prices may continue to creep higher for longer than we expected.

From the RBNZ's point of view, the inflation outlook is much more comfortable compared to six months ago – a point that should be reinforced by the December quarter CPI to be published this Thursday, where we expect annual inflation to moderate to 2.2%. Even as recently as the December *Monetary Policy Statement*, the RBNZ's stance was that it was prepared to act early to lean against inflation pressures once reconstruction in Christchurch got under way. The recent softening of inflation expectations, plus the slowing global economy and the ongoing tensions in European markets, should give the RBNZ scope to hold off on interest rate hikes until later in the year.

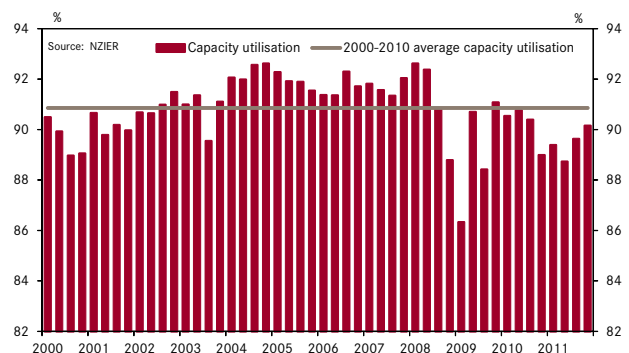
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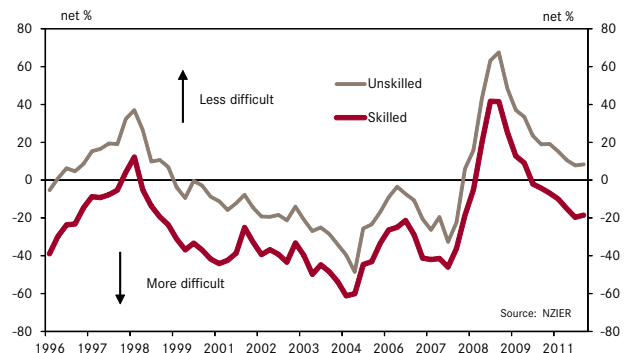
Domestic trading activity



Capacity utilisation



Firms' difficulty in finding labour



Pricing Intentions vs CPI

